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TREASURY FOR DAVID WRIGHT

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SIPDIS

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SUBJECT: SWEDISH VIEWS OF LATVIA'S 2010 BUDGET PROPOSAL

¶1. (U) Summary: Sweden is optimistic about Latvia's 2010 budget proposal, but Stockholm is concerned about the income distribution effects of the measures. Sweden's appeals to shift more of the fiscal adjustment burden from expenditure cuts to tax increases have been rejected by Riga so far. Supporting measures that fail to protect the poorer part of the Latvian population will become increasingly difficult for the current Swedish government as it may face criticism from the center-left political opposition. End Summary

¶2. (SBU) On October 26, the Latvian government announced a budget deal that included the required 500 million lats in savings in the 2010 budget. On October 22, in discussing Latvia's agreement to this level of savings, the Swedish Finance Ministry Assistant State Secretary told the Embassy he assessed the Latvian situation as rather good, certainly better than it appeared only a few weeks ago. There are some indications that the budget situation for 2009 is not quite as gloomy as previously predicted, he said. He explained that some revenues are greater than expected and suggested that this might make up for some of the optimistic calculations on the proposed budget cuts for 2010. The Swedes assess that some of the proposed budget cuts will lead to a worsened situation for the poorer part of the population; such as a lower basic income deductible, as well as lower deductions for families with children. Taken together, the measures with the wrong income distribution effects amount to around 50-60 Million Lats, about 10-12 % of the required cuts.

¶3. (SBU) The Assistant State Secretary for Finance said it is no secret that the Swedish government (and IMF and the EU) would like to see other measures in the budget. The Latvian government has refused to consider Swedish budget suggestions in the past by objecting that the measures are not politically feasible. For example, Swedish believe Latvia could raise its property tax on a par with other countries and could replace large parts of the cuts on income deductions. Instead, the property tax has now been reduced to 0.1 % in the proposal, resulting in very little revenue. The Swedish government has also proposed a progressive tax rate to scale up the whole income tax scale, across the board. The Assistant State Secretary said that other measures, such as increasing the VAT and Swedish Finance Minister Anders Borg's "favorite measure" of increasing the pension age, now reportedly 59 years, have been similarly rejected. (Comment: The Latvian government has agreed to some tax measures, many of which were recommended by the IMF and EU. End Comment)

¶4. (SBU) The Assistant State Secretary told us that the Latvian government, IMF, and EU took part in a telephone conference on October 22 to discuss the revenue side of the budget (with Latvian Finance Minister Ainars Repse taking part). The telephone conference did not go very well, according to the Assistant State Secretary, with the IMF and EU expressing serious concerns about the income distribution profile of the proposed budget cuts. The EU and the IMF urged the Latvian government to reconsider the measures, but Repse defended the budget proposal since it was the only politically viable solution in Latvia. Repse indicated the Latvian government intends to present the budget to the Parliament on October 28. (The

Latvian government postponed the budget submission deadline to Monday, November 2, after the EU and the IMF demanded the latvian government give them more time to analyze and respond to the budget proposal.)

¶5. (SBU) The parties held another teleconference on 23 October, this time to discuss the expenditure side of the budget. The Assistantn State Secretary lamented that the documentation provided by the Latvian government is very difficult to understand in order to have a meaningful review and discussion about the cuts. Although less politically sensitive than the revenue side of the budget, the Swedish government has particular concerns about cuts affecting schools and hospitals, but those measures have been already decided.

¶6. (U) Comment: The Swedish government is very concerned about the income distribution effects of the Latvian measures, and have for a long time argued for tax increases, rather than expenditure cuts. Among other reasons, the Alliance government here knows that it will be open to attacks from the opposition if the Latvian government adopts a budget with this type of income distribution profile as part of the IMF program. This might be a difficult issue to handle for the Swedish government as it moves towards the next general election here in 2010. End comment.

¶7. This cable has been coordinated with Embassy Riga.